

Message Text

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DRAFTED BY EB:TOENDERS, DESIGNATE

APPROVED BY EB - MR. ENDERS

S/S :WHLUERS

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TOSEC 34

E.O.11652: GDS

TAGS:OVIP(KISSINGER, HENRY A.)

SUBJECT: MEETING WITH CHANCELLOR SCHMIDT

REFERENCE: SECTO 15

FROM ENDERS

1. ON GOLD, SCHMIDT'S DESIRE HAS BEEN TO FIND A MIDDLE GROUND BETWEEN THE NEED OF FRANCE AND ITALY TO MOBILIZE THEIR GOLD RESERVES TO FINANCE HEAVY PAYMENTS DEFICITS, AND THE TRADITIONAL US (AND GERMAN) POSITION ON THE NEED TO PHASE GOLD OUT OF THE INTERNATIONAL MONETARY SYSTEM. SCHMIDT THUS SUPPORTED THE EC INITIATIVE TO PERMIT MONETARY AUTHORITIES TO BUY AND SELL GOLD AMONG THEMSELVES AND ON THE FREE MARKET AT MARKET-RELATED PRICES. WE BELIEVE THAT HE WAS GRATIFIED BY PROMPT US COUNTER INITIATIVE WHICH RESULTED IN 11 JUNE SEQUOIA AGREEMENT:

A) THAT THERE WAS NO OBSTACLE TO COUNTRIES UP-VALUING THEIR GOLD RESERVES;

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B) THAT GOLD COULD BE PLEDGED AS COLLATERAL FOR LOANS; AND

C) THAT ADDITIONAL CHANGES ARE NEEDED IN PRESENT AGREEMENTS ON GOLD TO PROTECT AGAINST EFFORTS TO REINSTATE GOLD AT THE CENTER OF THE SYSTEM, TO PREVENT INFLATIONARY EFFECTS

ON GOLD REVALUATION AND TO RESPOND TO LDC NEEDS. SIMON IS TO STOP IN BONN IN LATE JULY FOR FURTHER TALKS. MEANWHILE, POINTS TO MAKE ARE:

--WE ARE GRATIFIED AT PROGRESS OF THE SEQUOIA GROUP, BUT THINK A MORE COMPLETE AGREEMENT ON GOLD IS NEEDED;

--WE ARE PARTICULARLY PLEASED AT CLOSE US-GERMAN COORDINATION ON GOLD OVER THE YEARS AND HOPE IT CAN CONTINUE;

--EMERGING SYSTEM MUST GUARD BOTH AGAINST ATTEMPTS TO RETURN TO GOLD STANDARD, AND AGAINST INFLATIONARY IMPACT OF GOLD REVALUATION.

2. ON INFLATION AND THE OIL SHOCK PROBLEMS SCHMIDT HAS EXPRESSED PESSIMISM. LIKE ALL POST WAR GERMAN LEADERS HE HAS A PARTICULAR ABHORRENCE FOR INFLATION. HE DOUBTS OTHER EUROPEAN COUNTRIES (ITALY IN PARTICULAR, BUT ALSO BRITAIN) WILL HAVE THE STRENGTH TO TAKE THE DEMAND RESTRAINT MEASURES REQUIRED. HE REASONS THAT HEAVY FUNDS RECYCLING THROUGH THE EUROCURRENCY MARKETS CANNOT BE SUSTAINED BECAUSE TOO MUCH OF THE BORROWING IS LONG-TERM AND TOO MUCH OF THE LENDING (BY ARABS) IS SHORT-TERM. HE THUS FEARS A WAVE OF RESTRICTIONISM ON THE ITALIAN MARKET WHICH COULD CAUSE THE COLLAPSE OF EUROPEAN AND WORLD TRADING ARRANGEMENTS, AND SERVE UNEMPLOYMENT IN EXPORT-ORIENTED GERMANY. POINTS YOU SHOULD MAKE TO HIM ARE:

--WE TOO FEAR INFLATION, AND ARE ACTING TO CUT BACK OUR BUDGET DEFICIT TO A MINIMAL AMOUNT; ALL COUNTRIES MUST RESTRAIN DOMESTIC DEMAND;

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--WE MUST REALIZE, HOWEVER, THAT NO MATTER WHAT WE DO IN INTERNATIONAL MANAGEMENT, OUR COLLECTIVE DEFICIT VIS A VIS OIL PRODUCERS WILL STILL BE DOLS. 40 BILLION;

--THUS WE HAVE NO ALTERNATIVE BUT TO SHORE UP THE EUROCURRENCY MARKET AND MAKE IT WORK; THIS MAY REQUIRE MORE REGULATION OF BANKS OPERATING IN THAT MARKET, MORE SUPPORT FROM THE BUNDES BANK AND FEDERAL RESERVE

FOR THEM, AND NEW RECYCLING INSTITUTIONS BACKED BY GOVERNMENTS;

--WE ALSO MUST MAKE SURE WE USE EXISTING INTERNATIONAL MACHINERY (OECD PARTICULARLY) TO COORDINATE OUR BALANCE OF PAYMENTS POLICIES SO THAT WE DO NOT ENGAGE IN COMPETITIVE AUSTERITY CAMPAIGNS;

--WE MUST INSIST ON FAITHFUL EXECUTION BY ALL PARTIES OF OECD AND IMF TRADE RESTRICTIONS.

3. ON ASSISTANCE TO ITALY, THE GERMANS HAVE TAKEN A HARD-NOSED VIEW (WE DON'T KNOW SCHMIDT'S PERSONAL VIEW). THEY HAVE INSISTED THAT THE ITALIAN GOVERNMENT TAKE STIFF DEMAND RESTRAINT MEASURES AS A PRECONDITION FOR ASSISTANCE; THEY HAVE BEEN SKEPTICAL ABOUT THE CONTENT OF ITALIAN AUSTERITY MEASURES NOW UNDER NEGOTIATION IN ROME; AND HAVE BEEN SENSITIVE TO IMPLICATIONS THAT THEY AS EUROPE'S MAIN SURPLUS COUNTRY SHOULD FOOT MOST OF THE ITALIAN BILL. YOU MAY WISH TO SAY:

--ITALIAN FINANCIAL LEADERS AND ITALY'S FRIENDS RECOGNIZE THAT STRONG EFFORTS BY THE ITALIAN GOVERNMENT TO RESTRAIN DEMAND ARE PRECONDITIONS FOR ADDITIONAL FINANCIAL ASSISTANCE;

--BUT PROBABLY THE MEASURES THE ITALIANS TAKE WILL FALL SHORT OF WHAT WE THINK IS NEEDED;

--POLITICAL STAKES IN ITALY ARE SO HIGH THAT WE CANNOT RISK A FINANCIAL COLLAPSE;

--WHAT WE THUS NEED IS AN APPROACH TO EMERGENCY ASSISTANCE
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WHICH GIVES THE ITALIANS ENOUGH TO KEEP GOING, BUT KEEPS THE PRESSURE ON THEM TO TAKE ADDITIONAL DEMAND RESTRAINT MEASURES;

--AS EUROPEAN LEADERS, IT SEEMS TO US APPROPRIATE THAT GERMANS TAKE THE INITIATIVE IN DEVELOPING SUCH A PACKAGE; WE ARE PREPARED TO TAKE PART AND CAN SEND OVER AN OFFICIAL TO GERMANY TO START PLANNING WHEN AND AS THE GERMANS ARE READY.

4. ON ENERGY, SCHMIDT BELIEVES THAT RADICAL INCREASES IN OIL PRICES HAVE CAUSED A SHOCK IN THE EUROPEAN ECONOMY TO WHICH IT MAY NOT BE ABLE TO ADJUST. HE WILL BE INTERESTED IN YOUR VIEWS ON HOW OIL PRICES CAN BE REDUCED, AND ON CONSUMER COOPERATION. YOU MAY WISH TO

MAKE THESE POINTS:

-- WE ARE NOW APPROACHING THE CRUNCH ON OIL PRICES.

A SMALL SURPLUS IS APPEARING: INVENTORIES ARE FULL
OIL MOVING BY SEA IS SLOWING DOWN; SPOT PRICES ARE
SOFTENING;

-- PROBLEM NOW IS TO TRANSLATE THIS SHIFTING
DEMAND/SUPPLY BALANCE INTO LOWER PRICES. WE ARE ATTEMPTING
TO ORGANIZE AN INTERNATIONAL EFFORT WITH MAJORS, PRINCIPAL
INDEPENDENT COMPANIES, AND MAJOR CONSUMERS (FRG, JAPAN,
BRITISH, HOLLAND) TO PERSUADE COMPANIES FROM SETTLING
BUYBACK NEGOTIATIONS OR BIDDING ON NEW OIL AT OR ABOVE
93 PERCENT OF POSTED PRICE. IF WE CAN SUSTAIN THIS
EFFORT, WE HAVE A CHANCE TO BREAK THE PRICE.

-- MEANWHILE WE NEED TO PUSH AHEAD WITH CONSUMER
COOPERATION IN THE ENERGY COORDINATING GROUP (ECG).
ECG HAS NOW LAUNCHED IN INTENSIVE EFFORT TO NEGOTIATE
AN INTEGRATED EMERGENCY PROGRAM OF DEMAND RESTRAINT,
STOCKPILING, AND OIL SHARING IN A NEW CRISIS. THIS EFFORT,
WHICH WE HOPE CAN BE BROUGHT TO A CONCLUSION THIS SUMMER,
HAS OUR FULL SUPPORT. IT SHOULD HELP SHIFT THE BARGAINING
BALANCE BETWEEN CONSUMERS AND PRODUCERS.

-- WE THINK IT IMPORTANT TO ASSOCIATE FRANCE
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WITH THIS EFFORT AT THE RIGHT POINT, NOT SO EARLY
AS TO UNRAVEL THE SUBSTANTIAL PROGRESS ALREADY MADE,
AND NOT SO LATE AS TO CONFRONT FRANCE WITH A FAIT
ACCOMPLI. WE SHOULD LOOK AT THIS PROBLEM FURTHER, PERHAPS
IN JULY, WHEN ECG WORK HAS MOVED FORWARD SUFFICIENTLY. SISCO

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